How To Attract Foreign Investment

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Up till now, too much attention has been paid to foreign direct investment rather than the indirect one with the result that the local finance market integrated to a certain degree into the world market but it suffered imbalance between the direct investment (some US$26 billion now) and the indirect one (only US$300 million). This imbalance prevents foreign - invested companies from transferring their money to the stock market, attracting more capital from this market or withdrawing their capital when necessary. That is why a breakthrough in policies on foreign investment, especially the indirect one, is much needed. In addition, policies to help local companies get access to foreign sources of finance are also much needed.

1. Why did Vietnam fail to attract foreign indirect investment?

Up to the end of 1996, there had been eight foreign mutual funds (FMF) capitalized at some 400 million but six of them shut down because of poor performance. Two funds left are VEIL and VFF. After the stock exchange came into being in Vietnam, some more funds made their appearance, such as the Mekong Enterprise Fund, Vietnam Opportunities Fund and PXP Vietnam Fund. At present, the VEIL is considered as the biggest fund and investor in the Vietnamese stock market with a total capital of US$133 million. The total indirect investment from these foreign funds, however, is only US$240 million, much lower than the 1996 mark.

Although FMFs have brought about many benefits in recent years, they are facing many risks because the local investment climate failed to cope with changes during the integration process. Some shortcomings in the investment climate are as follows:

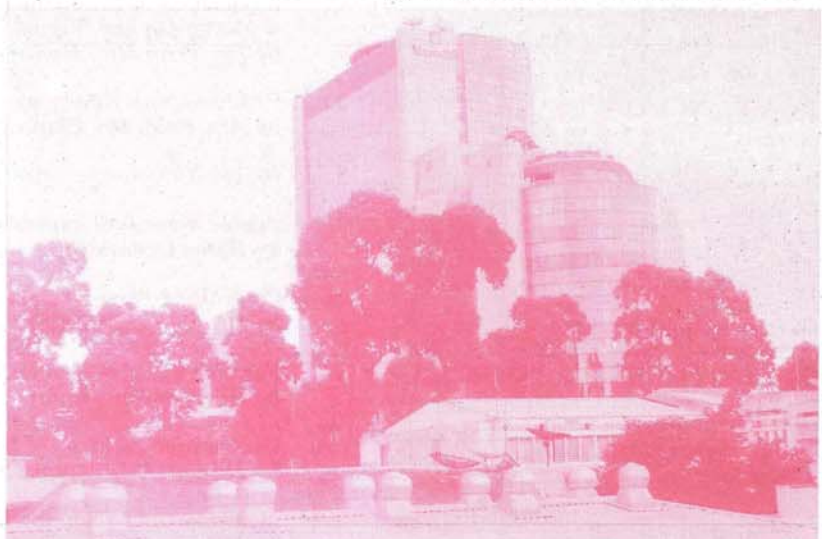
- Strict control over foreign capital: Regulations about transactions in capital accounts are necessary for preventing losses of capital from the balance of payments, but these regulations are too strict. Foreign investors, for example, are not allowed to hold more than a 30% stake of a company. According to economists, it's the investment climate, not these regulations, that made investors keep their capital in Vietnam. Dominic Scriven, Director of the Dragon Capital, said that Vietnam could attract some US$300 million more if foreign investors were allowed to hold 49% instead of 30%.

- Poor legal infrastructure: There is no overall law on the initial public issue, so companies issue shares according to the Companies Law, commercial banks issue according to the Banking Institution Law while state-owned companies issue according to Decree 64 on the privatization.

- Small-scale stock exchange: There are less than 30 listed companies capitalized at VND3,600 billion and only 50% of their shares are traded because the State holds the better part of them.

- Intransparency: At present, there is no standard for the accounting applied to mutual funds. Financial statements publicized by companies are not trustworthy in the eye of potential investors because some companies, such as Bibica and Hạ Long Canned Food Companies, didn't disclose true information.

- Prejudice against FMFs: Policies pay too much attention and incentives to the foreign direct investment and give nothing to the indirect one. Of course, policy makers have reasons to do it but now Vietnam should lift such barriers to ensure a level playing field when it wants to integrate into the world market or international organizations.



Foreign indirect investment in recent years not only increases the supply of much- needed capital but also produces many positive effects, such as:

- Improving companies' managerial skills and financial transparency: FMFs have done it by investing in local companies and banks (such as REE, Bibica, Sacombank, VP Bank, etc.); and encouraging them to engage in the stock market.

- Helping with the development of stock market: According to many observers, the recovery of the stock market in 2003 originated partly in efforts by foreign funds to buy shares.

- Encouraging establishment of local mutual funds: With the presence of FMFs, some similar local funds have been granted licenses (such as the VFM capitalized at VND16 billion). This could be seen as the beginning of the development of mutual funds in Vietnam.

2. Policies to attract international flows of capital

These policies could aim at (1) encouraging local companies to get access to FMFs in Vietnam, and (2) helping local funds integrate into the international finance market.

a. Attracting indirect investment through mutual funds:

From above analyses, we could see that measures to attract foreign indirect investment through FMFs must aim at improving the investment climate and reform obsolete policies that reflect prejudice against the FMFs.

- Removal of control over capital outflow: International practices show that most countries keep a close watch on capital inflows and almost raise no barriers to the capital outflows. These barriers discourage short-term capital from the outside by imposing heavy taxes on profit from short-term investment or high required reserves deposited with the central banks. The removal of control over the capital outflows will certainly be one of the best measures to attract foreign indirect investment to Vietnam.

- Reducing required stake held by the State: Vietnam could consult the proportion of shares that are forced to sell to the State in China when this country gets accession to the WTO. To make the investment climate more competitive and improve the opportunity to join the WTO, the Government had better allow foreign investors to buy up to 49% of the shares issued by a company. In the near future, this limit could be removed totally.

- Making the Securities Law: This law will serve as a basis for the stock market to develop healthily and effectively, avoiding conflicts between Companies, Banking Institutions Laws and PM Decree on the privatization program, and allowing all companies to get equal opportunities to engage in the stock market.

- Tax incentives: These incentives are indispensable among instruments for controlling the economy used by most countries. According to many experts, mutual funds in Japan developed to the highest level in Asia because of tax incentives. The Government had better allow a 5-year exemption from profit tax instead of the 2-year one as today's regulation.

- Privatization of government monopolies: At present, many FMFs are waiting for government monopolies and state-owned commercial banks to be privatized. They have declared they are ready to invest in these privatized companies. Regrettably, efforts made by the Government to privatize the VCB in July 2004 ended in failure and there is no sign of the privatization of government monopolies.

b. Helping local companies get access to the international capital market:

There are more and more companies from all over the world looking for capital in foreign stock exchanges. Some Vietnamese companies have also made plan to do it. The problem is the difference over countries in the way to make financial statements. And as a result, Vietnamese companies have to study a lot of laws and regulations before engaging in foreign stock exchanges. And this is no easy task.

To help them in this effort, the Government should work out new strategies. For the time being, the Vietnamese Accounting System (VAS) must be improved according to international standards because, according to many experts, there are a lot of differences between it and the International Accounting System.

Although the Government has adopted a plan to establish strong banking groups and allow them to issue share on foreign stock exchanges, but this plan seems infeasible because of the above-mentioned differences which the banking authority alone couldn't deal with.

In addition, as suggested above, the Government should change basically its policies on the privatization of government monopolies in order to introduce securities of higher quality to the local stock market before thinking of foreign ones ■